

# SixTen and Associates Mandate Reimbursement Services

**RECEIVED**  
September 22, 2014  
Commission on  
State Mandates

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September 22, 2014

Heather Halsey, Executive Director  
Commission on State Mandates  
980 Ninth Street, Suite 300  
Sacramento, CA 95814

Dear Ms. Halsey:

RE: CSM 05-4206-I-12  
**Santa Monica Community College District**  
Fiscal Years: 2001-02 and 2002-03  
Health Fee Elimination  
Education Code Section 76355  
Statutes of 1984, Chapter 1, 2<sup>nd</sup>. E.S.  
Statutes of 1987, Chapter 1118  
Incorrect Reduction Claim

I have received the Commission Draft Proposed Decision (DPD) dated September 4, 2014, for the above-referenced incorrect reduction claim, to which I respond on behalf of the District.

## PART A. APPLICATION OF AN INDIRECT COST RATE

The audit asserts that the District overstated its indirect cost rates and costs in the amount of \$146,966 for both fiscal years. This finding is based upon the Controller's statement that the district did not obtain federal approval for its ICRPs, a stated requirement of the Controller's claiming instructions.

The threshold Commission conclusion is that claimants must comply with the Controller's claiming instructions and that the Controller's use of its own instructions and forms to recalculate the indirect cost rates was not arbitrary. The District asserts that the Controller's claiming instructions are not alone enforceable as a matter of law as they are not regulations nor were they adopted pursuant to the administrative rulemaking process required to enforce agency manuals and instructions, as did the

*Clovis Court.*<sup>1</sup>

The Controller has never asserted that its claiming instructions are alone legally enforceable (DPD, 15):

The claiming instructions contained in this manual are issued for the sole purpose of assisting claimants with the preparation of claims for submission to the State Controller's Office. These instructions have been prepared based upon interpretation of the State of California statutes, regulations, and parameters and guidelines adopted by the Commission on State Mandates. Therefore, unless otherwise specified, these instructions should not be construed in any manner to be statutes, regulations, or standards.

Therefore, any documentation standards or cost accounting formulas published in the claiming instructions, to be enforceable, must derive from another source. However, there are no cost accounting standards for calculating the indirect cost rate for the Health Fee Elimination mandate published anywhere except the Controller's claiming instructions.

The Commission (DPD, 15) instead relies upon the "plain language" of the 1989 parameters and guidelines:

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<sup>1</sup> From the Clovis Appellate Court Decision (4):

"Once the Commission determines that a state mandate exists, it adopts regulatory "[P]arameters and [G]uidelines" (P&G's) to govern the state-mandated reimbursement. (§ 17557.) The Controller, in turn, then issues nonregulatory "[C]laiming [I]nstructions" for each Commission-determined mandate; these instructions must derive from the Commission's test claim decision and its adopted P&G's. (§ 17558.) Claiming Instructions may be specific to a particular mandated program, or general to all such programs." Emphasis added.

From the Clovis Appellate Court Decision (15):

"Given these substantive differences between the Commission's pre-May 27, 2004 SDC P&G's and the Controller's CSDR, we conclude that the CSDR implemented, interpreted or made specific the following laws enforced or administered by the Controller: the Commission's pre-May 27, 2004 P&G's for the SDC Program (§ 17558 [the Commission submits regulatory P&G's to the Controller, who in turn issues nonregulatory Claiming Instructions based thereon]; and the Controller's statutory authority to audit state-mandated reimbursement claims (§ 17561, subd. (d)(2))." Emphasis added.

Claimant is incorrect. The parameters and guidelines plainly state that "indirect costs may be claimed in the manner described by the State Controller." The interpretation that is consistent with the plain language of the parameters and guidelines is that "indirect costs may be claimed," or may not, but if a claimant chooses to claim indirect costs, the claimant must adhere to the Controller's claiming instructions.

Claiming indirect costs is not conditional on the claiming instruction methods. Colleges "may" claim indirect costs, or any other eligible cost, on every mandate, not just Health Fee Elimination. The Commission attribution of the conditional "may" to the ultimate decision to claim indirect costs, rather than the subsequent discretionary choice to use claiming instructions method is gratuitous.

Regarding the requirement for the administrative rulemaking process to enforce agency manuals and instructions, the Commission (DPD, 16) misses the factual issue:

Moreover, the Commission is not the venue in which to challenge the Controller's claiming instructions on the ground that those instructions may constitute an underground regulation. Until the courts declare otherwise, the Commission will presume that, where reasonable and consistent with the parameters and guidelines, the Controller's claiming instructions are valid and enforceable.

The Commission does not need a court to declare the claiming instructions to be underground regulations or to ascertain whether they are consistent with the claiming instructions. The Commission need only ask the Controller if the claiming instructions have been adopted pursuant to the required process. If the answer is no, the Commission cannot enforce the claiming instructions for the Controller. The Controller's use of the FAM-29C method for audit purposes is a standard of general application without appropriate state agency rulemaking and is therefore unenforceable (Government Code Section 11340.5). The formula is not an exempt audit guideline (Government Code Section 11340.9(e)). State agencies are prohibited from enforcing underground regulations. If a state agency issues, enforces, or attempts to enforce a rule without following the Administrative Procedure Act, when it is required to, the rule is called an "underground regulation." Further, the audit adjustment is a financial penalty against the District, and since the adjustment is based on an underground regulation, the formula cannot be used for the audit adjustment (Government Code Section 11425.50).

Somehow the "assistance" provided by the claiming instructions has become a requirement even though the parameters and guidelines use the word "may." The Commission now has concluded that the contents of the claiming instructions are as a matter of law derivative of the authority of the parameters and guidelines, without benefit of a legal citation for this leap of jurisprudence. Assuming for argument that the leap can be made, would that derivative authority continue for any changes made to the

claiming instructions after the adoption of the 1989 parameters and guidelines, that is, an open-ended commitment of the Commission's authority to the Controller who can make changes without reference to the Commission process? Is this derivative authority limited to Health Fee Elimination or applicable to all mandates?

Note that the Health Fee Elimination parameters and guidelines were amended on January 29, 2010. However, the indirect cost rate language remained the same:

### 3. Allowable Overhead Cost

Indirect costs may be claimed in the manner described by the State Controller in his claiming instructions.

The Commission has had numerous opportunities to clarify its intent and language regarding the indirect cost rate calculation methods and resolve or avoid the delegation and derivation issue. For example, and by contrast, the parameters and guidelines language for the new college mandate Cal Grants, adopted on the same date as the January 29, 2010, amendment for Health Fee Elimination, has the needed specific and comprehensive language:

#### B. Indirect Cost Rates

Indirect costs are costs that have been incurred for common or joint purposes. These costs benefit more than one cost objective and cannot be readily identified with a particular final cost objective without effort disproportionate to the results achieved. After direct costs have been determined and assigned to other activities, as appropriate, indirect costs are those remaining to be allocated to benefited cost objectives. A cost may not be allocated as an indirect cost if any other cost incurred for the same purpose, in like circumstances, has been claimed as a direct cost.

Indirect costs include: (a) the indirect costs originating in each department or agency of the governmental unit carrying out state mandated programs, and (b) the costs of central governmental services distributed through the central service cost allocation plan and not otherwise treated as direct costs.

Community colleges have the option of using: (1) a federally approved rate, utilizing the cost accounting principles from the Office of Management and Budget Circular A-21, "Cost Principles of Educational Institutions"; (2) the rate calculated on State Controller's Form FAM-29C; or (3) a 7% indirect cost rate.

This language in the parameters and guidelines for Cal Grants makes the Controller's guidance on the suggested three choices of indirect cost calculation methods legally enforceable. The Commission properly adopted this language within the scope of their

discretion and has utilized it in college mandate parameters and guidelines since at least 2002. However, this language has never been adopted by the Commission for Health Fee Elimination. The District agrees that the parameters and guidelines have the force of law, but that it does not extend by reference (tenuous or not) to the general or specific claiming instructions for Health Fee Elimination. Neither the Commission nor the Controller have ever adopted the Controller's claiming instructions pursuant the process required by the Administrative Procedure Act, nor has the Commission ever before stated that parameters and guidelines are subordinate to the Controller's claiming instructions.

In the absence of legally enforceable claiming instructions, rules or methods, or standards or specific language in the parameters and guidelines for the indirect cost rate calculation, the remaining standard is Government Code Section 17561. No particular indirect cost rate calculation method is required by law. Government Code Section 17561(d)(2) requires the Controller to pay claims, provided that the Controller may audit the records of any school district to verify the actual amount of the mandated costs, and may reduce any claim that the Controller determines is excessive or unreasonable. The Controller is authorized to reduce a claim if the Controller determines the claim to be excessive or unreasonable. Here, the District computed indirect cost rates utilizing cost accounting principles from the Office of Management and Budget Circular A-21, and the Controller has disallowed the rates without a determination of whether the product of the District's calculation is excessive, unreasonable, or inconsistent with cost accounting principles.

There is no rebuttable presumption for this mandate that the Controller's methods are per se the only reasonable method. The Controller made no determination as to whether the method used by the District was reasonable or not, but merely substituted the Controller's method for the method used by the Districts. The substitution of the Controller's method is an arbitrary choice of the auditor, not a "finding" enforceable either by fact or law. In order to move forward with the adjustment, the burden of proof is on the Controller to prove that the District's calculation is unreasonable. Indeed, federally "approved" rates which the Controller will accept without further action, are "negotiated" rates calculated by the district and submitted for approval, indicating that the process is not an exact science, but a determination of the relevance and reasonableness of the cost allocation assumptions made for the method used. Neither the Commission nor the Controller can assume that the Controller's calculation methods are intrinsically more accurate and the Commission cannot shift that burden or create the presumption to the contrary where none is present in law.

## **PART B. UNDERSTATED OFFSETTING REVENUES**

This finding is the result of the Controller's recalculation of the student health services fees which may have been "collectible" which was then compared to the District's student health fee revenues actually received, resulting in a total adjustment of

\$538,244 for the audit period. The Controller computed the total student health fees collectible based on state rates while the District reported actual fees collected.

The Commission (DPD, 20) finds that the correct calculation and application of offsetting revenue from student health fees have been resolved by the *Clovis Unified* decision, and that the reduction is correct as a matter of law:

After claimant filed its IRC, the Third District Court of Appeal issued the *Clovis* decision, which specifically addressed the issue of whether the Controller properly reduced reimbursement claims for state-mandated health services provided by community college districts pursuant to the *Health Fee Elimination* program using the "The Controller's Health Fee Rule." The Health Fee Rule, as stated in the Controller's *Health Fee Elimination* Program specific claiming instructions, provides that a reimbursements will be reduced by the amount of *student fees authorized*. As quoted by the court, the Health Fee Rule states in pertinent part:

Eligible claimants will be reimbursed for health service costs at the level of service provided in the 1986/87 fiscal year. The reimbursement will be reduced by the amount of student health fees authorized per the Education Code [section] 76355.

The District agrees that claimants and state agencies are bound to apply the Health Fee Rule as decided law and that this extends to retroactive fiscal years still within the Commission's or Controller's jurisdiction.

On October 27, 2011, the Commission adopted a consolidated statement of decision for seven Health Fee Elimination incorrect reduction claims. The statement of decision for these seven districts included issues presented in this current incorrect reduction claim. The application of the Health Fee Rule, as determined by the Commission's October 27, 2011, statement of decision, however, involves two factual elements: the number of exempt students and the specific enrollment statistics for each semester. That decision approved the Controller's use of specific Community College Chancellor's MIS data to obtain these enrollment amounts. That approved method is stated in the more recent HFE audits as:

**FINDING— Understated authorized health service fees**

We obtained student enrollment data from the CCCCCO. The CCCCCO identified enrollment data from its management information system (MIS) based on student data that the district reported. CCCCCO identified the district's enrollment based on its MIS data element STD7, codes A through G. CCCCCO eliminated any duplicate students based on their Social Security numbers. *Cited from the October 19, 2012 HFE Audit Report for State Center CCD. Available at the*

*Controller's web site.*

For the audit of this District, completed before the October 27, 2011, Commission decision, the enrollment statistics used by the auditor were different:

**FINDING 2— Understated authorized health fee revenues claimed**

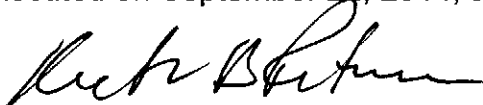
We obtained student enrollment information from the “enrollment census” data run and student waiver information from the list of “BOGG used” data run.

Therefore, to properly implement the Health Fee Rule, it will be necessary for the Controller to utilize the statistics approved by the October 27, 2011, decision. Until then, the Commission’s ultimate conclusion that the adjustments here are not arbitrary or lacking in evidentiary support is unfounded.

**CERTIFICATION**

By my signature below, I hereby declare, under penalty of perjury under the laws of the State of California, that the information in this submission is true and complete to the best of my own knowledge or information or belief, and that any attached documents are true and correct copies of documents received from or sent by the District or state agency which originated the document.

Executed on September 22, 2014, at Sacramento, California, by



Keith B. Petersen, President  
SixTen & Associates

Service by Commission Electronic Drop Box

**DECLARATION OF SERVICE BY EMAIL**

I, the undersigned, declare as follows:

I am a resident of the County of Solano and I am over the age of 18 years, and not a party to the within action. My place of employment is 980 Ninth Street, Suite 300, Sacramento, California 95814.

On September 23, 2014, I served the:

**Claimant Comments**

*Health Fee Elimination, 05-4206-I-12*

Education Code Section 76355

Statutes 1984, Chapter 1, 2nd E.S.; Statutes 1987, Chapter 1118

Fiscal Years 2001-2002 and 2002-2003

Santa Monica Community College District, Claimant

by making it available on the Commission's website and providing notice of how to locate it to the email addresses provided on the attached mailing list.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct, and that this declaration was executed on September 23, 2014 at Sacramento, California.



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Heidi J. Palchik  
Commission on State Mandates  
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# COMMISSION ON STATE MANDATES

## Mailing List

**Last Updated:** 8/18/14

**Claim Number:** 05-4206-I-12

**Matter:** Health Fee Elimination

**Claimant:** Santa Monica Community College District

### TO ALL PARTIES, INTERESTED PARTIES, AND INTERESTED PERSONS:

Each commission mailing list is continuously updated as requests are received to include or remove any party or person on the mailing list. A current mailing list is provided with commission correspondence, and a copy of the current mailing list is available upon request at any time. Except as provided otherwise by commission rule, when a party or interested party files any written material with the commission concerning a claim, it shall simultaneously serve a copy of the written material on the parties and interested parties to the claim identified on the mailing list provided by the commission. (Cal. Code Regs., tit. 2, § 1181.3.)

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